



Approved Retirement Funds - 12 Years On Are they doing the job?

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Well there's good news and bad news!

THE GOOD news is that we are continuing to live healthier and longer in retirement.

Statistics show that a man retiring at age 60 now needs a retirement fund capable of supporting at least 20 years of retirement income. A woman at age 60 now expects to live on average until age 84 and needs a fund to provide income for at least 4 years longer. Further good news is that these figures represent average expectations, meaning many of us will live considerably longer.

The bad news is that both state and private pension structures are facing increasing difficulties in providing us with secure income during our retirement years.

From a state pension perspective those of us turning 50 this year will not receive our old age pension until age 68. With the current financial crisis demanding further budgetary cuts and the National Pension Reserve fund being called upon to meet more immediate exchequer needs it is difficult to rely on the state to provide meaningful levels of retirement income for all citizens in future years. Public sector employees face similar strain on their unfunded pension expectations and face uncertainty regarding benefit levels in the future.

Over 70% of private sector defined benefit schemes cannot meet current Pensions Board minimum funding standards. Most are already closed to new members with many others already in wind up phase or destined for wind up. As a result the majority of private sector workers are now covered by defined contribution (DC) pension plans.

Extra Risks for Defined Contribution Schemes

Investors in DC pension plans have always been exposed to carrying 100% of the investment risk but now must also carry the risk of improved life expectancy. Traditionally DC pensions were provided by purchasing an annuity from a life office at point of retirement. While the annuity

provided certainty of income for life it also meant giving up all ownership and control over a retirement fund built up over 30 or 40 years of hard work. Self employed investors in particular felt aggrieved at ceding all control over their post retirement funds.

Approved Retirement Funds (ARF)

In 1999, the Minister for Finance answered these calls by introducing the Approved Retirement Fund (ARF) which removed the need to purchase annuities for contributors to personal pension plans and for certain company directors. The ARF permitted drawdown of retirement income as needed with any balance remaining on death passing to a spouse, other dependents or to the estate. Subsequent legislation allowed AVC and PRSA investors avail of similar ARF options. The ARF option proved very popular with most retirees opting to retain control of their funds. Finally this year's Finance Act extended the ARF option to **all** employees retiring from DC schemes who fulfil certain conditions. However with this good news came the requirement for the ARF investor to withdraw at least 5% of the ARF value each year in order to avoid deduction of imputed tax at 41%.

The Big Question

So in 2011 what we know is that the ARF is the popular choice for both self employed and employees when it comes to planning for retirement income and financial security for dependents. What we don't know is how well the ARF has delivered to date against these objectives and very importantly how well it can deliver into the future against the backdrop of increasing age longevity and increasing economic uncertainty.

The Case Study

Take a 60 year old business owner who retired 10 years ago in 2001 with a significant ARF fund of €600,000. Throughout some very turbulent economic cycles, the average Irish pension managed fund return over the 10 year period to

June 2011 was 0.7% per annum. If an income of €30,000 (5% of initial ARF value) was taken from the fund each year and the annual fund management charge was 0.5% per annum then the fund remaining 10 years later is less than €310,000. Problem is the retiree has completed only 50% of the average retirement life expectancy for a male and only 42% if female. Heading into the next 10 years with just over half the original fund remaining, given similar investment results the fund will run out by year 20 unless income is reduced.

The Verdict

The jury is out on the traditional ARF. If retirement income provision is the primary objective – can the ARF we know produce the result or do we need to redesign the structure to deliver greater security of income going forward?

The New Concept in ARF Design – Lifelong Income Benefit

This month sees the introduction of a new concept in retirement income delivery with the arrival of Canada Life's new Approved Retirement Fund featuring Lifelong Income Benefit.

Now for the first time retirees can maintain control over their ARF funds and simultaneously enjoy the security of a minimum level of retirement income which is guaranteed for life and is not dependent on the performance of the underlying ARF funds.

Lifelong Income Benefit has proved a very popular retirement income feature in North America and Canada and has recently been introduced to European markets by providers with the required financial capacity to underwrite the income guarantees.

The Canada Life ARF with Lifelong Income Benefit is available to pension investors between the ages of 60 and 80 who have already exercised ARF options or are now entitled to exercise ARF investment options.

Details are available now from your Pension Broker, your Canada Life Financial Consultant or at www.canadalife.ie.

